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**The Need For Coordination Of Pension Systems In Balkans**  
with a focus on Albania, Macedonia and Kosovo<sup>1</sup>

**1. Social policy context**

This paper will treat one of the social challenges facing the Western Balkan countries in the process of European integration, the need for coordination of the old age pension systems. Along with the economic cooperation, the social security coordination is an important aspect for the European integration of Balkan countries. After 2000, the social policy has taken a special attention in EU agenda, reflected on the EU assistance projects for Western Balkan, with a regional approach. It was related even with the progress done by the Balkan countries in the process of EU integration. Macedonia is become a candidate for EU membership, whereas Albania after signing the Stabilisation and Association Agreements with the EU, is applying for being a candidate country. Kosovo is enjoying the independence<sup>2</sup> and is in the process of state building, under the international assistance, but at the same time is inspiring for EU integration.

Social policy developments, especially the reformation of pension systems reflect internal transition policies in each country, policy transfer from international organizations after the fall of socialism regimes, and increasingly, the influence of EU integration processes. On the other side, pension system not only reflects the changes of the whole social system, but it is one of the instruments to influence the changes. Especially it can put incentives for the labour market participation for both, males and females, mobility of the labour force, etc.

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<sup>1</sup> Some of the findings from a study on "Sustainability of pension system in Balkan", supported by ERSTE Foundation, 2009.

<sup>2</sup> On 17 February 2008, the Kosovo Parliament adopted the Declaration of Independence.

Building up new pension schemes or remodeling the existing ones to respond the new social and economic realities in the Balkan countries was one of the priorities in the strategic objectives for each country. Social state is sanctioned on the basic legislation – Constitution and the guaranteeing the social rights remains the priority on the strategic objectives. Therefore, the process of decision making in this domain should be balanced between the social needs and economic development priorities.

There are used different approaches and established a variety of pension schemes in Albania, Kosovo, and Macedonia. The Albanian old-age pension system is based on the typical Bismarck model, which is actually under process of reformation even in the origin country of Germany. The Kosovo old-age pension system was built as a quite new system based mainly on the Beveridge model. In the Macedonian system, there are combined two ways of financing the old-age pension schemes developed in the European countries: pay-as-you-go and the capital funded, so it is following more the Swedish model. Why such different approaches when Albania, Kosovo and Macedonia have common general indicators such as: small number of population, relatively young population, more than 50 per cent of the population under 35 years old, high level of unemployment, low GDP per capita, etc.

**Table 1.** General indicators on Western Balkan Countries

	Croatia	Bosnia & Herzegovina	Serbia	Montenegro	Macedonia	Kosovo	Albania
Populations in 2007 (in millions)	4.4	3.8	7.4	0.6	<b>2.0</b>	<b>2.1</b>	<b>3.2</b>
Population in 2030 (projection in millions)	4.2	3.7	7.5	0.6	<b>2.0</b>	*	<b>3.5</b>
Population/km <sup>2</sup> of land in 2007	79	75	96	45	79	189	110
Fertility rate in 2006	1.38	1.18	1.43	1.64	<b>1.41</b>	<b>3.21</b>	<b>1.37</b>
Under 35 years old in 2006 (in %)	42.7	47.6	42.3	49.2	<b>50.4</b>	*	<b>58.6</b>
Over 55 years old in 2006 (in %)	5.7	3.1	6.6	4.2	<b>3.8</b>	*	<b>2.5</b>

GDP (per capita in euro),2006	7.700	2.542	3.434	2.519	<b>2.432</b>	<b>940</b>	<b>2.099</b>
National debt (in % of GDP),2006	40.9	21.3	37.0	38.0	<b>37.6</b>	*	<b>59.7</b>
Employment rate, 2006	55.6	35.0	49.9	34.8	39.6	28.7	49.7
Unemployment rate, 2006	11.1	31.1	21.0	30.3	36.0	44.9	14.1
Women's employment rate, 2006	49.4	24.0	40.6	27.6	30.7	11.8	38.8
Average age, 2005	40.6	37.1	36.6	35.1	34.2	*	28.6
Life expectancy, 2006	75.4	74.8	73.2	72.8	73.6	69.0	75.9
Infant mortality, 2006	5.2	7.5	7.4	11.0	11.5	12.0	7.4

\*no data available

Source: Krohnert –Hobmann-Klingholz, Europe's Demographic Future, Berlin Institute for Population and Development, 2008, page 325.

Our societies have the advantage to make use of the EU experiences to construct their modern systems of pensions, as they are opened to the influences of the EU developments. On the other side, Balkan countries are no longer entirely free to prevent each other pension system from competing on its own territory with the system it has built. The social security in Western Balkans traditionally has been closely linked to employment status, both in the previous system and even in the reformed system. With the transition to a market economy the employment status of large sections of the populations changed: from employed in state sector now are unemployed, and are trying to find a way to a kind of self-employment or family business. On the other side, the growth of the informal economies has had a negative impact on the reformed pay-as-you-go social security systems.

The regional approach in analysing the pension system is used based on the fact that Balkan countries are facing the same challenge to build at the same time the democratic regimes, free markets, legal and social states. Despite recent economic growth, the countries of the Western Balkans have low levels of GDP per capita,

compared to European countries. These countries also have great difficulty connecting to the global economy. Deindustrialisation has destroyed jobs and led to high level of SME and self-employment in Macedonia, and even more in Albania. Unemployment, informal economies, low incomes and households who depend heavily on remittance incomes are the common features of these countries.

Low inflows of international capital, low export competitiveness and widespread poverty cannot allow the Albania, Macedonia and Kosovo to face the competitiveness with the global economy in such opened systems. These countries did realize the need for the regional co-operation, which is very crucial for their development. The economic cooperation and relations between the Balkan countries underline the importance of enhancing the free mobility of other productivity factors, such as labor force, which is looking to find a place in the regional market. Free movement of the labor force can be facilitated with the coordination of social security and the guaranteeing the pension rights, wherever the people decide to live during their retirement.

The importance of common issues/challenges and the complexity of pension systems are raising the question for their coordination, using the EU experience in Open Method of Coordination.

## 2. Pension reforms

Pension system inherited from the former Yugoslavia as well the Albanian pension system were a Defined Benefits system, where retirees receive benefits based on the number of working years as well as on the basis of their salaries. The pensions were fully indexed to wage growth, so that the living standards of the elderly were sometimes better than the living standards of the working age population. Pensions aim was protecting the social status, and their replacement rate varied from 70% to 80% of wage, after 20-40 working years. Retirement ages were less than 60 for men and 55 for women. In addition, special privileges were granted for a wide range of workers, like miners, allowing them to retire earlier, with no reduced amount of benefits. The system was financed on a pay as you go basis (PAYG), mainly centrally administered.

After 1990s, all Western Balkan countries have adopted pension reforms in order to relieve pressure on the state budget from increased social demands. Under the assistance of international organizations, mostly of the World Bank, several countries have introduced partially privatized three pillar pension systems, in the environment of underdeveloped capital markets. The term “three pillar” pension scheme is connected to the three pillar model advocated by the World Bank in the report *Averting the old age crisis*, published in 1994. The three pillars consist of:

1. A mandated, unfunded and publicly managed defined benefit system.
2. A mandated, funded and privately managed defined contribution system;
3. A voluntary retirement system.

In principle, the reform of pension systems reflects political choices, historical traditions and the specific economic challenges faced by the different countries. In many Western European countries the term second pillar is often associated with the supplementary pension schemes set up under collective labor agreements. In some countries such collective schemes have a semi public character and the affiliation of the employers and employees may be rendered obligatory by law. In other countries the collective schemes are set up on a strictly private basis, while participation is not necessarily obligatory. The main characteristics of the second pillar pensions are:

- obligatory for the participants;
- based upon the capitalization method as opposed to the pay-as-you-go principle;
- managed by funds which operate under private law;
- based upon the defined contribution principle.

Such characteristics are typical for the second pillar pension schemes introduced in Croatia Macedonia and Kosovo, while Albania, Serbia, and Montenegro are still remodeling the existing pension systems.

Due to low employment rates, grey economy and a poor record in contribution collections, the PAYG pension system in Albania, as well as in other countries of the Western Balkans are under severe strain. Even private companies and self-employed operating in the formal economy often pay based on the minimum wage, which means that many people will receive just the minimum pension. Second, it means that Health Funds, Pension Funds and Employment Funds often operate at a deficit and must be supplemented by governments' already stretched budgets, reducing resources for other social expenditures. Despite the fact that pensions are in low levels, the pension expenditures have been expensive absorbing about 9% of GDP in Macedonia, and 5% of GDP in Albania.

Pro-market privatised three-pillar pension reforms have been introduced in Croatia, Macedonia and Kosovo, creating a mandatory individual savings scheme. In this kind of schemes, which is linking benefits with contributions, it will be more difficult for the government to create privileges for special categories, like in the former system, (for example for miner, military forces, etc.). The main challenge for Balkan countries in transition is the 'informal' employment. This is one of the factors for remodeling the pension systems from wage-oriented model to the defined contribution pension system. In the three pillar pension system, it is combined the pay-as-you-go method of financing with other methods, for developing self-supporting schemes, as well as to share the responsibilities between the state,

employers and their employees. The state has to make sure that the insured persons are objectively informed about the consequences of their choices, for example for specific pension funds or investment arrangements.

Public pension schemes have only been subjected to some marginal parametric reforms in Albania, Serbia, and Montenegro. "Given the risks inherent to the three pillar pension systems which have already been introduced in the region, countries which have not yet introduced such schemes - Albania, BiH, Montenegro, and Serbia - may be well advised to pursue further reform, and focus on improving the effectiveness of existing pay-as-you-go pension systems, rather than rushing headlong into the partially privatised systems".<sup>3</sup>

Country	Starting	First pillar	Second Pillar	Third Pillar
Albania	1993 1995	PAYG DB -21.6% Mandatory + Voluntary	Supplementary for senior civil servant and military forces PAYG	Voluntary Private Pensions
Kosovo	2002 2007	Social Pension 40 Euro + 35 = 75 Euro/15 years	Fully Funded 5:5 =10% Mandatory <55	Voluntary Fully Funded pensions
Macedonia	1993 March 2002 January 2008	PAYG DB-12,35% remain in the Mandatory Voluntary	2005 - Fully Funded 6.65% Mandatory – all employed after 1 <sup>st</sup> January 2003 Voluntary -others	Voluntary Fully Funded

<sup>3</sup> EJSS article – Bartlett & Xhumari 2007.

Increasing the coverage as well as the replacement rate remains the main challenges of the pension system in Balkan. The redistributive element is still stronger, like in the previous regime. Common challenge for all Balkan states is that pension systems to be better suited to the market condition, to increase work incentives; to give priority the insurance principle; comparing with the income redistribution; to encourage payment of the contributions in higher levels, and consequently the higher benefits in return.

Today EU is emphasizing new principles as social solidarity and social inclusion. All the social actors, even the vulnerable groups need to be involved in the policy making process. This idea comes out after a long history of the organizations of the interested groups, which today are ready to come in the game of political process with new ideas to protect the interest of the groups they represent. How it can happen in our societies, where the social awareness is still underdeveloped and the representatives of groups not yet cristalized?

### 3. EU Integration - the need for coordination of pension systems in Balkan

Being **the EU integration as the main priority** for Balkan countries is facilitating the use of the EU experience and objectives on pensions.

Along with the importance of bilateral agreements in social security within Balkan countries, the coordination of the first pillar of the pension system will be very soon in the main agenda of social policy. Which are some of the main characteristics of the first pillar of the old age pensions in some of the Balkan countries?

**Table 2.** Comparative data on the first pillar of the old age pensions, 2007

Countries	Average monthly pensions (€)	Replacement rate (%)	Pension contribution rates (%)	Share of pension expenditure in GDP (%)	Number of beneficiaries/ of the over 65 years old population
Albania	50	43.4 – urban 27 – rural	21.6	5.5	130% of the over 65
Croatia	257	34	20.0	14	n.a yet
Macedonia	38-80%	42	21.2	9.6	n.a yet

<b>Montenegro</b>	91.70	56.7	24.0	17	40,000/ 48.2% of the over 65 83% - male
<b>Serbia</b>	90 70- farmers	61	22.0	10.5	385,000 70% of the over 65 211,000-farmer
<b>Kosovo</b>	45 - basic 85 - with 15 years insurance		10.0 – second pillar	3.5 <sup>4</sup>	100% - there is a basic pension

The social security is an instrument which provide safeguard against the risks of the uncertain economic development, such as temporary or permanent dropping out of the workers from the labour market. *As long as the market is globalized, the instruments such as social security are globalized as well. So, common rules need to be established to guarantee the social rights of the labour force wherever they decide to work and live in their retirement, for today and for tomorrow.*

What is happening in Balkan countries is that they are moving in the adverse direction. If today the EU states are discussing how to coordinate the pension schemes established hundred years ago, the Albania, Macedonia and Kosovo have had similar pension systems during the socialist regimes, and now are reforming it in a diversified way that may create problems for the free movement of people and services, when the Shengen will be established. How is the pension system responding to the free market, free trade, free movement of the labour force and services in the Balkan region, to better accommodated in the flexible environment?

How the pension system is responding to the diversified social structures, demographic and family changes? Should the pension system strengthen the values such as equality through the high redistribution instrument aiming in poverty alleviation, in such countries dominated by self-employment, or it has to function for income replacement based on contributive principle and social justice? If the EU today is looking for new forms of social solidarity, does the redistributive element, as the main feature of the previous socialist system need still to be strengthen? Does the pluralistic political system, implemented in the governance of social security through tripartite governing bodies, and the new labour relations are in conformity with such a high level of redistribution in public pension system? The main question is how to

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<sup>4</sup> Studies on 'Social Protection and Social Inclusion' in the Western Balkan countries:  
[http://ec.europa.eu/employment\\_social/spsi/enlargement\\_en.htm#studies](http://ec.europa.eu/employment_social/spsi/enlargement_en.htm#studies)



organise social protection systems in such a way that they help, in particular, to guarantee that everyone has the resources necessary to live in accordance with human dignity, which mean that active population to pay as much as they can provide incomes necessary for elderly and to have enough for themselves. These are crucial questions for the future developments of the pension systems.

The pension institutions are in the process of remodeling to increase their sustainability and adequacy of benefits, to be flexible in new realities, which are in rapidly changes and to be in conformity with required standards in the process of EU integration. The process of EU Integration of the Balkan countries has put in the agenda social protection and inclusion when pension is one of the priorities. The ILO Convention 102/1952 on the Minimum Standards of Social Protection must be the underline principle on the strategic objectives for the development the sustainable social protection systems. This is another tool for integration of pensions with other social benefits, respecting the rules on coverage and adequacy of benefits.

The focus is the need for coordination of the old age pension systems in Albania, Macedonia and Kosovo, in the process of European integration of such countries. How the European experience is used in the co-ordination of the pension system. The EU integration process of Balkan countries has created the natural environment for more regional cooperation in economy, which is expecting to bring a free movement of the labor force and the need for guaranteeing their social rights.

#### **4. OMC-learning from each other, from the best experiences in region**

The coordination of the first pillar of the pension schemes in the Balkan and the Open Method of Coordination (OMC) may be used to share the best experiences on pensions. The regional economic cooperation, extending opportunities for the Balkan citizens who are moving and working in different countries of the region would require improvement in legal framework of the pension systems, and bilateral agreements between governments and the respective agencies responsible for administration of the pension schemes.

EU aims at preparing candidate and pre-candidate countries in the Open Method of Coordination on social inclusion and, from 2006, social protection.<sup>5</sup> Joint Inclusion Memoranda' (JIM) process outlines the principal challenges in relation to tackling poverty and social exclusion, and from 2006, in relation to three main fields: pensions, health and long-term care.

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<sup>5</sup> European Commission, DG Employment, Social Affairs and Equal Opportunities, Social protection and inclusion policies. Antonia CARPARELLI, Head of Unit EMPL E2: Conference on EU social protection and inclusion strategy, March 4, 2009 Tirana.

Overarching Objectives are:

- Social cohesion, equality between men and women and equal opportunities for all through *adequate, accessible, financially sustainable, adaptable and efficient social protection systems* and social inclusion policies.
- Effective and mutual interaction between the Lisbon objectives of greater economic growth, more and better jobs and greater social cohesion, and with the EU's Sustainable Development Strategy.
- *Good governance, transparency and the involvement of stakeholders in the design, implementation and monitoring of policy.*

In 2002, EU social policy cooperation started with the 10 countries which acceded in 2004. Learning process on both sides is based on the Social Protection & Inclusion Studies.<sup>6</sup>

Relating the 'Pre-Candidate' Countries co-operation on social protection is still in a preparatory phase. A series of seminars on the EU Social Protection and Social Inclusion Process, the latest March 4, 2009 in Tirana, as well as in other countries. Studies on 'Social Protection and Social Inclusion' are supported for all the Western Balkan countries.<sup>7</sup>

The public and even the social partners as well Academia are not enough informed about what the concepts of coordination of social security schemes and overall European social security policy imply and the rights and obligations after the accession.

In the Regional level –Integrated social protection will increase the choices, to promote access to stable employment and the pension rights connected with it. Social Security Coordination Network in Balkan is started with the Regional Co-ordination Centre on Social Policy in Skopje. It needs much attention to develop and support the

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<sup>6</sup> The current 3 Candidate countries: Croatia-JIM signed in March 2007, second JIM follow-up period 2009-2010, Turkey -JIM process launched in late 2004, but not yet signed, and the former Yugoslav Republic of Macedonia -accession negotiations have not yet started, JIM process not yet launched.

<sup>7</sup> [http://ec.europa.eu/employment\\_social/spsi/enlargement\\_en.htm#studies](http://ec.europa.eu/employment_social/spsi/enlargement_en.htm#studies), which are used as a point of reference.

comparative studies in the context of the EU integration of the Western Balkan countries. For sure that importance of an integrated approach, of public and private pension schemes, not only to make a decisive impact on the eradication of poverty among elderly population, but also to ensure adequate pensions is the main priority. In this difficult road our countries need to develop transparency with contributors and beneficiaries, more information and awareness of the public on what is going on with reforms of the pension system.

I am emphasizing the application of the OMC in Balkan countries, as an instrument to share and learn from the each other experience, mainly on pension schemes, and more concretely:

What can learn Albania from the experience of other countries in reforming the pension system?

- Building the trust on pension system by reducing the redistributive elements
- Introducing the tax incentives for employer schemes
- Replace abusive support for self-employed in agriculture with productive incentives – the same rules of game
- The state to guarantee for all elderly a minimum income by knowing the insurance periods in service work at home as well as the coefficients for difficult jobs
- The guarantee pension from the compulsory pension scheme at the level of 40% average replacement rate – ILO Convention 102/1952 (Ratified,2005)
- Improve adjusting mechanism to differentiate the benefits according the contributions and maintain the social status, fix in law the time of indexing.
- Sanctioned by law the rights of migrant workers and bilateral agreements
- Encourage the second pillars, may be financed out by the employers
- Introducing insurance/allowance child benefits

What can learn Kosovo?

- Building the trust on the actual pension system, introducing or not a PAYG system for differentiating the pensions according to contributions
- Investing the pension savings in producing & exporting the energy in the country, aiming to increase the economic development and employment.
- Fix by Law the rules of indexing

What can learn Macedonia?

- Sharing the responsibility between the state, employer and the employees in contribution
- Economic Cooperation in Region for Investing the pension savings and increasing the employment
- No conditions (at least five years of insurance) for survivor pensions
- Gender approach – unify the rules

Reaching the strategic long-term social and economic stability, social policy aims *not only social protection of the citizens, but also to influence the development of human potentials*, changing of people's mentality to respect the rule of law. Citizens should learn that democracy is the respect of human rights, and that democracy can be reached with solidarity in the contributive pension system.

The main efforts need to be concentrated on the sustainability of the existing pay-as-you-go system. Decreasing the dependency ratio and increasing the replacement rate, remain the main challenges of the pension system today in Balkan countries. The influence of global market and price liberalisation eventually lead to a lowering of social standards. There is necessary to give shape a credible, effective and modern pension policy which is directly influencing all generations: young generation as contributors, and the old generation as beneficiaries.

Democracy in social policy implies the possibility that certain social interests be ever more broadly represented in the decision-making structures of the social policy. But interests are represented when groups and individuals are aware of them. The public *information* and awareness of all citizens for their rights and responsibilities to the social legislation will encourage the active participation of all actors in building sustainable social security systems. A conclusion from the history of social policy is that has been the pressure of the interested groups and of the social partners, one of the factors of the progress of the social programs. We need only to use this experience in our specific conditions, in our movement from collective consciousness and mechanic solidarity to individualism and organic solidarity. Understanding the social security institutions and the process of their developments is a source of power for everybody, because the way how it is functioning is of the interest for all members of our society.

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